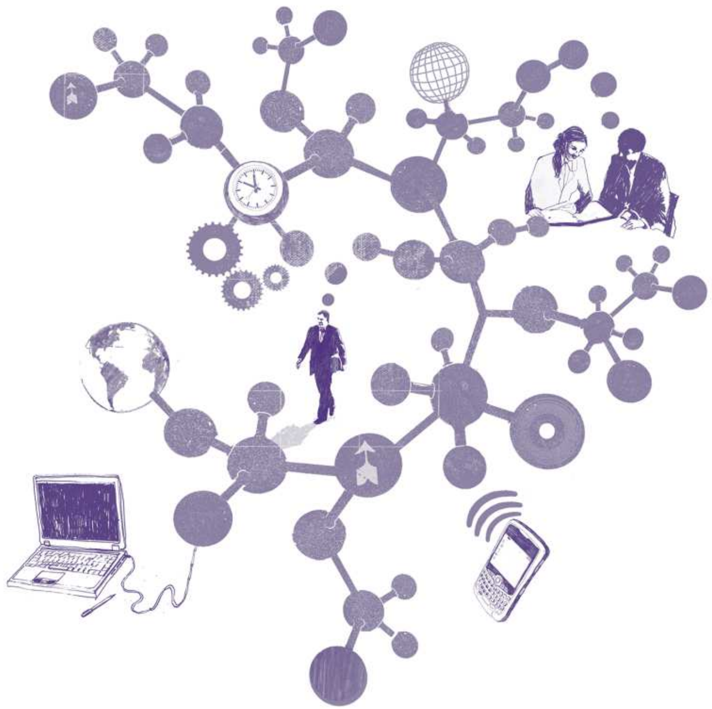
# The Annual Audit Letter for Herefordshire Council

**Year ended 31 March 2016**

October 2016



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# Contents

# Executive summary

## Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Herefordshire Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Governance Committee as those charged with governance in our Audit Findings Report on 22 September.

## Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's] financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

## Our work

**Financial statements opinion**

We gave an unqualified opinion on the Council's financial statements on 22 September 2016.

**Value for money conclusion**

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 22 September 2016.

**Whole of government**

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 18 October 2016, although we did refer to one mismatch in our submission to the NAO.

**Certificate**

We cannot formally conclude the audit and issue an audit certificate in accordance with the requirements of the Act and the Code until we have completed our consideration of matters brought to our attention by the Authority.

**Certification of grants**

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2016. We will report the results of this work to the Audit and Governance Committee in our Annual Certification Letter.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP**
**October 2016**

# Audit of the accounts

## Our audit approach

**Materiality**

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £6,637,000, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas such as cash, senior officer remuneration and auditor's remuneration.

We set a lower threshold of £332,000, above which we reported errors to the Audit and Governance Committee in our Audit Findings Report.

**The scope of our audit**

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

# Audit of the accounts - Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

| Risks identified in our audit plan | How we responded to the risk |
|---|---|
| **Accounting for the Better Care Fund**<br>The 2015/16 financial statements included a new material pooled budget under a s75 agreement.<br><br>The accounting treatment of this arrangement was complex in line with accounting standards in relation to Joint Arrangements (IFRS11) | We have performed the following procedures:<br>• Obtained and reviewed the s75 agreement in place between the Council and Herefordshire CCG<br>• We have established the Council's control environment in relation to the Better Care Fund and performed walkthroughs of key controls to ensure they are operating effectively<br>• We have reviewed the reasonableness of the judgements made by the participants in assessing the control over the funds, and hence the accounting treatment<br>• We have agreed BCF transactions, balances and disclosures in the accounts to the appropriate underlying evidence<br>**No significant matters arose form our work.** |
| **Valuation of pension fund net liability**<br>The Council's pension fund asset and liability, as reflected in its balance sheet, represents a significant estimate in the accounts and comprises 43% of its total liabilities.<br>The values of the pension fund net liability is estimated by specialist actuaries. | As part of our audit work we have:<br>• Documented and walked through the key controls put in place by the Council to ensure they were designed as expected.<br>• Reviewed whether the experts used by the Council were sufficiently knowledgeable and independent for us to rely on their work<br>• Reviewed the Council's instructions to its actuary and tested the information on staff and pensioners it gave them to calculate the pension fund liability.<br>• Reviewed the key assumptions made by the actuary using the work of an actuarial expert and tested whether any assumptions specific to the Council were appropriate.<br>• Checked that the Council had correctly made entries in its accounts following the report from the actuary.<br>**Our audit work has not identified any issues in respect of the valuation of the pension fund liability** |

# Audit of the accounts

## Audit opinion

We gave an unqualified opinion on the Council's accounts on 22 September 2016, in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to most of our queries during the course of the audit.

**Issues arising from the audit of the accounts**

We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Governance Committee on 22 September 2016.
This financial year the adoption of the accounting standard IFRS 13 (Fair Value Measurement) was reflected in the CIPFA Code of practice for 2015/16. The standard, which has been applied prospectively from 2015/16, provides a new definition and brings together fair value guidance into one standard that is applicable to almost all fair value estimates. We found that the financial statements were not in compliance with the enhanced disclosure requirements arising from the new standard in any respect. A number of enhanced disclosures were therefore made.
A significant change is reflected in the CIPFA code in relation to the 2016/17 accounts and will require valuation of the Council's network assets. Further detail is included later in this report. This is a significant task involving finance , highways staff and valuers and the impact on the accounts is expected to be highly material. We will be looking to see that the Council is making appropriate plans for the implementation of this change and would expect that appropriate assurance is provided to the Audit Committee by officers that this is being properly implemented.

**Annual Governance Statement and Narrative Report**

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared broadly in line with the relevant guidance and were consistent with the supporting evidence provided by the Council. We did suggest that specific reference was made to the weakness in capital reporting, officers confirmed the AGS action plan already identifies actions to improve record keeping data quality.

**Whole of Government Accounts (WGA)**

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO . We issued a group assurance certificate which made a reference to a mismatch which we had investigated and concluded that it was correctly stated from Hereford Council's perspective.

**Other statutory duties**

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in table 2 overleaf.

Based on our review, we are satisfied that, in all significant respects, the Council had proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. In our Audit Findings report we provided detailed findings against each of these criteria. However our high level observations were as follows:

**Health and Social Care Integration**

The Sustainability and Transformation Plan (STP) is being developed as part of the DOH five year forward view. We expect the plan to be published soon. This plan covers Herefordshire and Worcestershire and locally builds on the Health and Social Care Transformation programme, 'One Herefordshire'. The County has struggled to achieve significant 'transformation' to date to address the underlying financial and operational challenges. As with other STP plans nationally, we expect that the plans may propose some significant changes to what services are provided locally and how they are delivered, in order to achieve the levels of savings needed.

The Council is operating in a challenged health and social care economy. The Council's main partners in the county and the wider STP footprint area continue to report risk around their financial positions and are struggling to achieve the constitutional targets in a number of areas.

Pooled budget arrangements have been in place for a number of years but this year the CCG and Council extended these arrangements with the introduction of the 'Better Care Fund'. We concluded that the Council has adequate arrangements around the financial operation of these pooled budgets.

**Waste Incinerator PFI scheme**

The annual accounts reflect further planned commitments to the PFI scheme. We reviewed the financial arrangements and concluded that these were appropriate. This scheme continues to be a high profile matter locally with further challenge in October through the Information Commissioner regarding disclosure of redacted information in the waste contract to be made public.

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**Ofsted inspection of children's services**

The Council has a current, 2014/15, adequate overall OFSTED judgement of “requires improvement” to be good for its child protection and looked after children’s services. This is an improvement on its previous judgement in 2012/13. The Council has set an ambition to be graded overall good for these services in 2017, although this will depend on the OFSTED cycle and OFSTED framework.

There are financial pressures around the service with Childrens' Services directorate overspending against budget year on year. Whilst there are on-going financial and operational risks around children's services and 'looked after' children we are satisfied that the Council is taking steps to respond to these risks.

# Value for Money conclusion (cont)

**Local Enterprise Partnership**

As part of our review of risks, we considered the arrangements the Council has in place around partnership arrangements, specifically those around the Marches Local Enterprise Partnership.  We found that whilst there are clearly set out and approved governance and accountability arrangements, in practice these are still evolving.

**Capital monitoring**

We reviewed the arrangements that the Council has in place around capital budget monitoring.  There have been some well-documented errors in financial reports, however we do not consider that these indicate a weakness  in the underlying monitoring arrangements. There is scope to improve both the quality control of committee reports and to improve transparency in reporting around individual schemes. We will continue to review progress the Council is making in improving its reporting as part of the 2016/2017 audit

## Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

# Value for Money

**Table 2: Value for money risks**

| Risk identified | Work carried out | Findings and conclusions |
|---|---|---|
| **Health & Social Care Integration**<br>The Council is working in a challenged health and social care economy. The Council is seeking to deliver wide ranging changes and greater integration to ensure the financial sustainability of adult health and social care services through its transformation agenda and through working with partners in health. | We reviewed the project management and risk assurance frameworks established by the Council to establish how it is identifying, managing and monitoring these risks. | The Council is operating in a challenged health and social care economy. In line with national requirements the partners in the STP footprint area are developing the Sustainability and Transformation Plan. It is expected that this will build on local initiatives including the 'One Herefordshire' plan but also looking at solutions across the wider area. The area has struggled to deliver any significant changes and It is hoped that the STP plan and new leadership in the area will give much needed impetus to transformational change.<br><br>The introduction of the better care fund and incentive to pool budgets with partners in the health sector is a complex arrangement and requires robust governance and project management to ensure delivery and VFM is being delivered. We are satisfied from the evidence gathered that the Council has established. arrangements around the integration with health services which will provide appropriate oversight. This is due to the extensive board structure in place taking into consideration representatives of both parties to the s75 agreement, as well as NHS providers that are not party to the agreement, and thus encompassing fully the concept of collaboration.<br><br>Finally, the reporting process is thorough and frequent enough to keep up to date with emerging issues in a timely manner. The breadth of involvement is conducive to informed decision making by the relevant party and as such we consider that appropriate arrangements are being put in place to mitigate the risk, whilst recognising the overarching inherent financial risks within the system.<br><br>**On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements** |

# Value for Money

**Table 2: Value for money risks**

| Risk identified | Work carried out | Findings and conclusions |
|---|---|---|
| **PFI scheme – waste incinerator**<br>The council is a party to a significant PFI contract for a waste incinerator.  This is a significant financial commitment and has been a high profile matter.<br><br>This links with arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and to maintain statutory functions. | We obtained an understanding of where the council are in this project and how the financial implications are being managed and factored into financial plans. | We are satisfied that the Council has adequate arrangements in place to secure value for money in the delivery of the waste incinerator PFI agreement. This is supported by the stable financial position of the partnership, a forecast surplus for the Council and timely management of relationship and dispute issues resulting in limited financial impact.<br><br>It is evident from our review of documents  and through discussions with client personnel that the scheme has been factored in to the long term financial projections of the Council with loan repayments spread up to 2042 or the useful economic life of the plant.<br><br>The borrowing necessary has also been undertaken in line with the relevant prudential strategy and in a responsible manner. The majority of debt is sourced from PWLB at rates favourable to the council and thus resulting in a surplus on repayment.<br><br>We have gained assurance that governance procedures are being implemented to a satisfactory level which has included the audit committee discussing the scheme regularly and providing appropriate oversight at their meetings.<br><br>Finally, the financial and operational aspects of the scheme have also been reported on positively by external third parties, specialising in their respective areas. As such, we do not consider the waste incinerator PFI scheme to pose a threat to our value for money conclusion, no further work is proposed on this matter.<br><br>**On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements** |

# Value for Money

**Table 2: Value for money risks**

| Risk identified | Work carried out | Findings and conclusions |
|---|---|---|
| **Ofsted inspection of children's services**<br><br>The Council has a current, 2014/15, adequate overall OFSTED judgement of “requires improvement” to be good for its child protection and looked after children’s services. This is an improvement on its previous judgement in 2012/13. The Council has set an ambition to be graded overall good for these services in 2017, although this will depend on the OFSTED cycle and OFSTED framework, until such time this remains a significant risk to the Council's arrangements. | We reviewed the improvement plan, risk register , financial reports and met with the Children's services financial lead. No follow up inspection has taken place. | The Council has responded to the Ofsted inspections. There has been some change in senior staff which is providing challenge to some of the existing culture and arrangements. Following the inspection there has been a detailed improvement plan developed and we have seen evidence that this is monitored and updated regularly.<br><br>There has yet to be a follow up to the 2014/15 Ofsted inspection to assess whether the actions are addressing the underlying problems. Many of the weaknesses are being addressed by further reviews, not all of which have been completed. It would therefore be premature to conclude that the Council will achieve its stated ambition of being 'good' during 2016/17.<br><br>The Children's Services Directorate continues to overspend as reflected in a £2m overspend on the £24m budget in 2015/16 Quarter 1 financial information was not available at the time of our review, although it is anticipated that this will continue to show budget challenges although the council is taking steps to reduce risks.<br><br>Discussion with responsible finance officers indicates new measures are being taken this year, for example a fundamental change to the use of agency staff which should have recurring positive financial impact. Any new initiatives will take time to impact on the underlying financial position.<br><br>**Whilst there are on-going financial and operational risks around children's services and 'looked after' children we are satisfied that the Council is responding appropriately to these risks. On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements** |

# Value for Money

**Table 2: Value for money risks**

| Risk identified | Work carried out | Findings and conclusions |
|---|---|---|
| Governance arrangements, from Herefordshire Council perspective around the Local Enterprise Partnership | We reviewed the governance arrangements around the LEP to assess whether or not these are adequate and whether adequate information is supplied to those Charged with Governance (TCWG) to fulfil their responsibilities. | In 2015/16 the LEP received around £16m of income. Transactions that related to Herefordshire Council were not material but are expected to increase in future periods.<br><br>Accounting arrangements for the LEP are properly established and reflect the fact that the LEP is not an entity. The LEP has produced an annual report in 2015/16 which is important in view of the increasing amount of projects and funding going through the organisation.<br>The LEP has an agreed accountability framework which sets out the decision making and governances responsibilities of the Board, and Joint Committee. Governance arrangements in practice have been evolving over the last two years. It is the responsibility of the joint committee for 'ensuring accountability of budget making and policy decision'. However the committee has not met frequently and we have seen little financial information being reported to it.<br><br>**Appropriate accountability and reporting arrangements are in place in relation to the LEP. On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements** |
| Adequacy of the Council capital reporting | We reviewed reports to Council in relation to the 2015/16 capital programme. | • The capital budget for 2015/16 as presented in the revised 2015 MTFS differs to that presented in the 2016 MTFS, both in total and by a number of individual schemes.<br>• The revised presentation of the restated 2015/16 capital outturn report makes it difficult to track through what was originally approved in the 2015 MTFS (£67,929 restated total budget) to the 2016 MTFS 2015/16 budget and also to the reported out-turn (both £77,089 budget) by individual project.<br>• The Council has highlighted a number of errors in its reports over the period. The June outturn report was reissued.<br><br>There are clearly lessons to be learned around quality control of financial reporting to committee. It appears to us that these are errors, omissions and oversights rather then there being a deliberate intention to mislead.<br>Officers have acknowledged a need to review both the presentation of budget reports and the quality control surrounding their publication as part of the 2016/17 work plan.<br><br>**We concluded that the risk was sufficiently mitigated and the Council has proper arrangements** |

# Working with the Council

## Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work. We ran a Better Care Fund Workshop which meant we were able to agree with you and your partners the appropriate accounting and disclsoures around the arrangement prior to the accounts being drafted.

Sharing our insight – we provided regular audit committee updates covering best practice. Areas we covered included Innovation in public financial management, Knowing the Ropes – Audit Committee; Effectiveness Review, Making devolution work, Reforging local government. We have also shared with you our insights on advanced closure of local authority accounts, in our publication "Transforming the financial reporting of local authority accounts" and will continue to provide you with our insights as you bring forward your production of your year-end accounts.

## Working with you in 2016/17
## Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

# Working with the Council

The nature of these changes means that Finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, we have  a date in the diary for some preliminary discussions with the Council to assess the progress it is making in this respect.  . We will be considering the following matters and will report to you any concerns in relation to the following matters:

- Whether the Council has an implementation plan. and whether this in accordance with LAAP Bulletin 100 "Project Plan for Implementation of the Measurement Requirements for Transport Infrastructure Assets by 2016/17"
- Monitoring / progress against plan
- Level of resources allocated
- Issues arising on work completed to date on inventory and accounting records and in particular any gaps in assurance and how completeness is being determined
- Frequency and method of condition surveys
- If significant estimates are being used to create opening inventory and condition reports
- Support for locally generated rates for replacement of assets and
- Where the Council is not intending to use standard national models specified under the Tools section of the CIPFA Website

# Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and **provision of non-audit services**.

### Fees

| | Planned £ | Actual fees £ | 2014/15 fees £ |
|---|---|---|---|
| Statutory audit of Council | 124,405 | 124,405 | 165,873 |
| Audit of subsidiary company Hoople Limited | 14,000 | tbc | N/a |
| Housing Benefit Grant Certification | 4,571 | tbc | 7,220 |
| **Total fees (excluding VAT)** | **142,976** | | **173,093** |

### Fees for other services

| Service | Fees £ |
|---|---|
| **Audit related services:** | |
| • Teachers pension (tbc) | **4,200** |
| • SFA grant (tbc) | **3,000** |
| **Non-audit services** | **7,000** |

### Reports issued

| Report | Date issued |
|---|---|
| Audit Plan | March 2016 |
| Audit Findings Report | September 2016 |
| Annual Audit Letter | October 2016 |